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CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

No. 416

M. W. ALWORTH AND R. D. ALWORTH, AS TRUSTEES UNDER THE LAST WILL AND TESTAMENT OF M. H. ALWORTH, DECEASED,
Petitioners,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

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vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRIT OF CERTIORARI

Your petitioners respectfully represent:

That they are aggrieved by the judgment of the Circuit Court of Appeals, for the Eighth Circuit, rendered July 12, 1943 (136 Fed. (2d) 812), holding that your petitioners are subject to a deficiency Federal income tax for the calendar year 1937, as theretofore determined by the Commissioner of Internal Revenue, thereby reversing the decision of the Board of Tax Appeals (now Tax Court of the United States) entered June 10, 1942 (46 B. T. A. 1045), to the effect that your petitioners are not subject to such deficiency tax.

A.

SUMMARY STATEMENT OF THE MATTER INVOLVED

The petitioners are testamentary trustees under the will of M. H. Alworth, deceased. During the year 1937, they were the owners of 3/10ths of the outstanding capital stock

of Royal Mineral Association, a Minnesota corporation, which was organized about 1909 and liquidated near the end of 1939. Throughout its existence, that corporation owned certain mineral lands in Minnesota. Its income consisted of royalties paid for iron ore mined and removed under leases of said properties. In each year of its existence, it distributed to its stockholders all of its net earnings for the year and substantial amounts from depletion reserves on account of such ore so mined and removed. As a consequence, it never carried over from one year to another any earned surplus. In 1917, and each year thereafter, the net taxable income of the corporation, less Federal income taxes accrued for such year, was regarded as the portion of such distributions which constituted taxable dividends when received by the stockholders, the remainder being regarded as depletion or return of capital. There is no evidence that the Commissioner ever disputed the propriety or the accuracy of that method of determining taxable income so received by the stockholders, nor is there any evidence as to how such income of the stockholders was computed or determined prior to the year 1917.

The corporation's taxable net income for the year 1937 was $464,033.94. The Federal income tax on that amount was $92,552.88, which was paid in 1938. Pursuant to such long continued practice, the petitioners computed their 1937 Federal income tax by deducting from the corporation's taxable income for that year the Federal income tax accrued thereon and returned as taxable dividends their pro rata share of the balance, as follows:

Net income of corporation	$464,033.94
Less accrued Federal income tax thereon for the year 1937, payable in 1938	92,552.88
Balance of net income or profit distributed to stockholders	$371,481.06

Petitioners thereupon returned as taxable income their pro rata share as stockholders of such $371,481.06.

Thereupon, the Commissioner departed from the long-established method above described and refused to allow the trustees, in computing their own income for that year, to deduct from the corporation's net taxable income any part of its accrued but unpaid income tax, and proceeded to determine their income as follows:

Net income of corporation	$464,033.94
Less Federal income tax paid by corporation in 1937 on its 1936 income	30,606.76
Balance of net income or profit distributed to stockholders	$433,427.18

By this change, the Commissioner undertook to add $61,946.12 to the amount which the dividend-receiving stockholders of Royal Mineral Association were required to treat as income to them of the corporate distributions of the year. The trustees' pro rata share of that increase amounted to $18,534.36 and their individual income tax was thereby increased $5,289.66. The above recited facts are stated in the findings of the Board of Tax Appeals on page 10 of the Record, and in the opinion of the lower Court on page 24 of the Record. The Board of Tax Appeals, on petition for review, reversed the determination of the Commissioner and approved the original computations of the taxpayers. The Circuit Court of Appeals reversed the Board of Tax Appeals, and affirmed the decision of the Commissioner (136 Fed. (2d) 812). The matter is now before this Court on this Petition for a Writ of Certiorari.

B.

JURISDICTION

The basis upon which it is contended that this Court has jurisdiction to review the decision of the Court of Appeals is Section 347 of the Judicial Code (Title 28, Section 347, Federal Code Annotated), which provides:

> "In any case, civil or criminal, in the Circuit Court of Appeals * * * it shall be competent for the Supreme Court of the United States, upon the petition of any party thereto * * * to require by certiorari * * * that the cause be certified to the Supreme Court for determination by it with the same power and authority and with like effect as if the cause had been brought there by unrestricted appeal."

C.

THE QUESTION INVOLVED

Section 22 (a) of the Revenue Act of 1936 defines "gross income" for income tax purposes, and provides that it includes "dividends." Section 115 (a) defines "dividend" (for the purpose of this case) as "any distribution made by a corporation to its stockholders * * * out of earnings or profits of the taxable year." These and other sections of the Act are included in an appendix to Petitioners' Brief hereto attached. The question here involved requires a construction and application of those provisions and may be stated briefly and in condensed form as follows.

Whether, a corporation having distributed to its stockholders in any year all of its taxable earnings of that year, a stockholder may, in making his own personal Federal income tax return, deduct from the taxable income of the corporation for the year the Federal income tax accrued on that income, payable in the following year, in order to deter-

mine the amount of such distributions received by him which constitute taxable income to him. The problem is one of determining the actual earnings or profits received by the stockholder within the meaning of said Section 22 (a).

It is admitted that income taxes of the corporation in this case should be deducted in computing the taxable income of the stockholders included in corporate distributions received by them. The corporation being on a cash basis, it is the Commissioner's contention that the income taxes of the corporation so deductible are only those *paid* during the year. It is the taxpayers' contention that the income taxes of the corporation so deductible are those *accrued,* even though not paid until due in the following year, such Federal income tax not being deductible by a corporation under any circumstances in making its income tax return. The question is who is right.

Stated otherwise, the question at issue is as stated by the Internal Revenue Agent in Charge at St. Paul, in a letter of May 12, 1939, to Mr. Frank W. Wilson (now deceased), who then represented these taxpayers, as follows:

> "The sole question relates to the determination of the taxable portion of distributions received by the above taxpayer from Royal Mineral Association of Duluth. More particularly, the question presented is whether the available earnings and profits of that Association, which keeps its books and files its income tax returns on the cash receipts and disbursements basis, should be reduced by accrued Federal income tax for the year 1937, amounting to $92,552.88, or by Federal income taxes paid during the year 1937 on its 1936 income, amounting to $30,606.76."

Deduction of State income taxes is not here involved.

D.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT

Importance of Question Involved.

There is involved in this proceeding a construction of vital provisions of the Federal Income Tax laws found in the Revenue Act above mentioned, to-wit, Section 22 (a) and Section 115 (a), which are still unchanged and now in force so far as affects the questions here under consideration.

Conflict of Decisions.

The decision of the lower Court is directly contrary to that of the Circuit Court of Appeals of the Second Circuit in *Hadden vs. Commissioner,* 49 Fed. (2d) 709, handed down in 1931. In that case, there was the same problem of determining how much of corporate distributions received by a stockholder from a corporation making its income tax return on the cash basis constituted taxable income to him, and the Court of Appeals of the Second Circuit said:

> "There appears to be no sound reason why the current earnings or profits should not first be reduced by the amount of the tentative tax in determining the amount of the current or post March 1, 1913, earnings available for distribution of dividend. *Commissioner of Int. Rev. vs. James* (C. C. A. 2), 49 Fed. (2d) 707, decided May 4, 1931."

It is of course very desirable that the correct interpretation of the statutes be laid down promptly so as to provide for uniform application throughout the country, and thus avoid confusion, litigation and conflicting decisions in different circuits. We believe the Court will find the decision under review clearly erroneous.

PRAYER FOR WRIT

WHEREFORE, your petitioners pray that a Writ of Certiorari be issued out of and under the seal of this honorable Court, directed to the Circuit Court of Appeals for the Eighth Circuit, commanding that Court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the Record and all proceedings in case numbered on its docket 12517 entitled, "Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, vs. M. H. Alworth Trust, M. W. Alworth and R. D. Alworth, Trustees, Respondents," and that the judgment of said Circuit Court of Appeals be reversed by this Court, and that petitioners may have such other and further relief in the premises as to this honorable Court may seem meet and just.

Dated September 29th, 1943.

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